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October 1, 2004

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

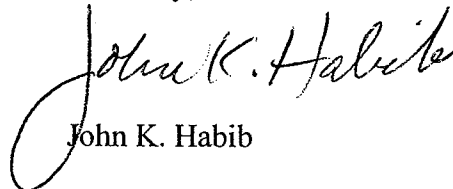
Re: Southern Union Company, D.T.E. 04-83

Dear Ms. Cottrell:

Enclosed please find the responses of Southern Union Company ("Company") to information requests DTE-1-12 and DTE-1-13 in the above-referenced proceeding. With this filing, the Company has submitted responses to each of the Department's discovery questions issued to date.

Thank you for your attention to this matter.

Sincerely,



John K. Habib

Enclosures

cc: Elizabeth Cellucci, Hearing Officer
John Cope-Flanagan, Hearing Officer
George Yiankos, Gas Division
Kevin Brannelly, Director, Rates and Revenues
Paul E. Osborne, Assistant Director of Rates and Revenues
Joseph Passaggio, Rates and Revenues
Glenn Shippee, Rates and Revenues
Jim Powell, Rates and Revenues
Richard Marshall

Information Request DTE-1-12

Reference the Prefiled Direct Testimony of Richard N. Marshall, Page 11, and Exhibit SU-3. Please justify the rationale for the exclusion of retained earnings in computing the net plant test for reasons other than to comply with Department precedent.

Response

The Department's precedent excluding retained earnings from the calculation of the net plant test stems from the plain language of the statute giving rise to the net plant test, G.L. c. 164, § 16. In relevant part, the statute states:

If, when the [D]epartment approves an issue of new stock, bonds or other securities by a gas or electric company, it determines that the fair structural value of the plant and of the land and the fair value of the nuclear fuel, gas inventories or fossil fuel inventories owned by such company is less than *its outstanding stock and debt*, it may prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time the impairment of the capital stock . . .

(emphasis added). Consistent with this language, the Department's net plant test requires a company to demonstrate that its net utility plant (utility plant less accumulated depreciation) is equal to or in excess of its total capitalization (the sum of long-term debt, preferred stock and common stock outstanding). Colonial Gas Company, D.P.U. 89-89, at 3 (1989). Thus, the purpose of the net plant test is to require a company to maintain a level of fixed investment that is sufficient to support its stock and debt requirements. By having sufficient fixed investments (i.e., utility plant), reasonable assurance can be provided to creditors of a utility that a company has sufficient tangible assets to cover its liabilities. Boston Gas Company, D.T.E. 03-40, at 321 (2003), citing Colonial Gas Company, D.P.U. 1247-A at 7 (1982); Report of the Department of Public Utilities Relative to the Capitalization of Gas and Electric Companies, Senate Document No. 315, at 8-15 (January 1922). The existence and level of retained earnings on a company's balance sheet are not part of the permanent capital structure of the Company. Since it is the permanent capital structure (i.e., the outstanding stock and debt) that supports investment in utility plant, retained earnings generally bear no relationship to the calculation of the net plant test.

However, the Company recognizes that, for Southern Union, a unique situation arises under the net plant test because the Company does not pay out its retained earnings each year as a cash dividend to shareholders. Thus, the values for common equity (i.e., the totals for Common Stock \$1 Par Value and Paid In Capital) on the Company's balance sheet include earnings actually "retained" by the Company and not paid out in the form of cash dividends. This is because the journal entries used to account for the stock dividend incorporate "Retained Earnings" (as of the Company's fiscal year end) into the totals for Common Stockholders' Equity on the balance sheet. For example, in this case, the stock dividend (and coinciding retention of retained earnings) is reflected in the balance sheet as of June 30, 2004. See, Response to Information Request DTE-1-15.

However, it is important to note that, until the Company elects to seek approval for the issuance of a stock dividend, current period "Retained Earnings" should not be included in the net plant test because they are not yet part of the Company's permanent capital structure and do not yet support utility investment. In any given year, the Company could elect not to issue a stock dividend, or to issue a dividend in cash. In that case, it would not be appropriate to stray from the Department's well-established precedent that Retained Earnings are excluded from the net plant test.

In Southern Union Company, D.T.E. 04-41, the Department stated that:

Because a company accounts for a stock dividend by a reduction to retained earnings, there is a corresponding increase in the company's common stock and premium on common stock, which is used in the determination of the net plant test. . . . Unless the accounting for the stock dividend, including the reduction to retained earnings, is made before the computations demonstrating compliance with the net plant test are made, the results would understate the company's capitalization used for the net plant test purposes.

D.T.E. 04-41, at 15-16. In the Company's Motion for Reconsideration in D.T.E. 04-41, the Company stated that:

[A]s the Department correctly notes, the calculation of the net plant test should follow accounting conventions because when GAAP journal entries are made to account for the dividend, there is a resulting increase in Common Stockholders' Equity when the amount of Retained Earnings (not included in the net-plant test) are

transferred into the Common Stock \$1 Par Value and Premium on Capital Stock accounts (which are included in the net plant test). Accordingly, the Company recognizes that, in the future, it is appropriate to calculate the net plant test to include the increase in Common Stockholders' Equity that will result from the journal entries made to account for the dividend, meaning that the Company will show *a post-issuance increase to capitalization in an amount equal to the reduction in Retained Earnings, as recorded in the journal entry.*¹

Motion for Reconsideration at 6-7. Thus, the Company recognizes that, at the time of a *future* filing for *approval of a stock dividend*, the Company will be required to submit a post-issuance calculation of net plant that includes Retained Earnings as Common Stockholders' Equity. This is the correct treatment because the journal entries made by the Company following the distribution of the dividend will have the effect of increasing Common Stockholders' Equity. However, until that time, the results of all *previous* stock dividend distributions are reflected in the Common Stockholders' Equity as of June 30, 2004, which serves as the basis of the net plant calculation in this proceeding.

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As stated in the Motion, the Company's motivation for filing for reconsideration was the Department's subsequent statement that because the Company did not calculate the net plant test in the filing to follow the accounting convention:

[T]he Company's capitalization for net plant test purposes fails to recognize the market value of the stock dividend, because there is no net change in the capital stock and premium on capital stock accounts.

See, Motion for Reconsideration at 7, citing, D.T.E. 04-41, at 16 (emphasis added). The Department's directive to change the calculation of the net plant test for stock dividend purposes stems from a stated concern that, unless the accounting for the stock dividend (including the reduction to retained earnings) is included in the net plant test, the results would understate the Company's capitalization for net plant test purposes. Similarly, the Company is concerned that the inclusion of the "full market value" of the stock dividend (when in excess of the retained earnings reflected in the journal entries) would overstate the Company's capitalization for purposes of the net plant test in a stock dividend filing. See, Motion for Reconsideration at 9.

Southern Union Company
Department of Telecommunications and Energy

D.T.E. 04-83

Information Request: **DTE-1-13**

October 1, 2004

Person Responsible: Richard N. Marshall/Counsel

Information Request DTE-1-13

Reference Exhibit SU-3. Please justify the exclusion of accumulated other comprehensive income in computing the net plant test for reasons other than to comply with Department precedent.

Response

The Company has not excluded Accumulated Other Comprehensive Income from the net plant calculation.